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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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In the matter of:

MORGAN FINANCIAL, LLC, an Arizona
limited liability company,

MORGAN FINANCIAL LENDERS, LLC, an
Arizona limited liability company,

JIMMY HARTGRAVES, JR. and LAURIE
HARTGRAVES, husband and wife,

Respondent.

DOCKET NO. S-20719A-09-0583

**SECURITIES DIVISION'S
RESPONSE TO RESPONDENTS'
POST-HEARING MEMORANDUM
PROVIDING INFORMATION
REQUESTED BY NINTH
PROCEDURAL ORDER**

The Arizona Corporation Commission, Securities Division ("Division") responds and objects to the following statements or representations included in Respondents' Post-Hearing Memorandum providing information requested by the ninth procedural order.

First, the Division objects to the unsupported classification of certain investors in Schedule A, columns C and D, as an "Experienced Lender" and twenty-one individuals as an "Accredited Investor." As noted in its post-hearing brief, the Respondents have the burden of establishing that their securities offers and sales completely satisfied the criteria of each exemption claimed. They did not meet this burden. Though not briefed by Respondents in their post-hearing brief, the Division explained in its post-hearing brief why the Respondents failed to establish that they qualified for an exemption pursuant to Rule 506 of Regulation D. See 17 C.F.R. § 230.506. Specifically, Respondents could not provide any tangible evidence that any investor was accredited or sophisticated, within the meaning of Rule 506 of Regulation D. As a result, it would now be improper to allow the Respondents to insert legal classifications that

1 attempt to make their exemption argument summarily, when they could not establish these facts
2 at the hearing. As such, Schedule A, Columns C and D should be stricken.

3 Second, the continued characterization by Respondents, that the Morgan Financial
4 Lenders, LLC ("MF Lenders") members "clearly supported the current structure by exchanging
5 their subordinated notes for membership interests" in MF Lenders, is inappropriate because it is
6 misleading and is not information requested by the ninth procedural order. In or around May
7 2010, when the investors exchanged their subordinated promissory notes for membership
8 interests in MF Lenders, the expectations and perceived real estate values of the Merrill Lynch
9 properties were greater. At the hearing, Mr. Hartgraves testified that the expectation around May
10 2010, was that all the investors, except Mr. Hartgraves, would be repaid their principal amount
11 because the loan portfolio carried a large positive equity balance. Hr'g Tr. Vol. II, p.254:17 – 25.
12 In addition, the exchange memorandum provided to investors stated that Morgan Financial
13 intended to repay the approximate \$6.2 million dollars of outstanding principal within thirty
14 months, and that Morgan Financial would be obligated to repay the principal amount irrespective
15 of how the Merrill Lynch loan portfolio performed. Ex. S-8, pp.1–2. However, in early 2011,
16 when Respondents executed Amendment Six to the Master Purchase Agreement with Merrill
17 Lynch, the loan portfolio no longer had a positive equity value based on Merrill Lynch's
18 appraisal. Instead, the loan portfolio had a negative equity value of approximately \$14 million
19 dollars. Hr'g Tr. Vol. II, p.348:14-17. Investors, at best, now hope Respondents can sell the
20 remaining properties so that 3% to 5% of the property sales value can be disbursed to them, pro-
21 rata so that they can at least get a fraction of their principal returned to them. At the time of the
22 exchange memorandum, none of the investors knew or expected that Respondents would not
23 honor their representation that they would still be obligated to fully repay the principal amount
24 outstanding irrespective of the loan portfolio performance or that the collateral would be
25 insufficient to cover the principal amount outstanding. Thus, the continued attempts by
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1 Respondents to present the May 2010, exchange as a reflection of the investors' current wishes is
2 misleading.

3 Finally, the Division disagrees with the characterization that an order of restitution
4 exceeding \$100,000 would leave the investors with nothing. The alternative is that no order
5 exceeding \$100,000 is entered against Respondents and therefore they have a limited obligation,
6 or none at all, to repay restitution to investors. As discussed during the hearing, the Merrill
7 Lynch contracts and agreements state that Morgan AZ Financial, LLC, or Morgan Financial,
8 LLC, which are owned and controlled by Respondents, have a contractual right to receive all
9 money, due and payable, by Merrill Lynch as part of the loan portfolio property sales. Hr'g Tr.
10 Vol. II, pp. 301:9 – 304:7. Even though Mr. Hartgraves testified that he has directed the amounts
11 Morgan AZ Financial, LLC earned in 2011 to MF Lenders directly, there is no document in
12 evidence that sets forth a legal requirement that he continue to do so once this administrative
13 proceeding is over. Mr. Hartgraves represents the proverbial fox guarding the henhouse.
14 Furthermore, as Mr. Hartgraves testified during the hearing, Merrill Lynch has been aware,
15 through annual accounting documents, that over five million dollars in promissory notes remain
16 outstanding as a debt obligation of Morgan Financial to investors. Hr'g Tr. Vol. II, pp. 317:8-
17 318:3. Even if an order of restitution is entered, it can not be assumed that Merrill Lynch will
18 automatically exercise their right to seize all the portfolio properties. Merrill Lynch may very
19 well allow Respondents to continue to service and sell the loan portfolio properties as they have
20 since 2008. In light of the investors' inability to legally or contractually direct or control
21 Respondents' actions regarding repayment or monies earned from the loan portfolio servicing,
22 the Division is concerned that not taking appropriate regulatory action and seeking an order of
23 restitution would increase the likelihood that investors are left with nothing.

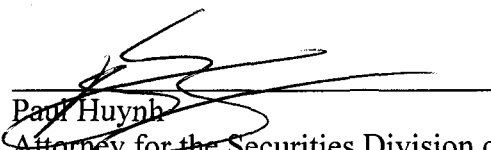
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1 RESPECTFULLY SUBMITTED this 26th day of October, 2011.

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3 By:


Paul Huynh
Attorney for the Securities Division of the
Arizona Corporation Commission

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6 ORIGINAL AND THIRTEEN (13) COPIES of the foregoing
7 filed this 26th day of October, 2011, with

8 Docket Control
9 Arizona Corporation Commission
10 1200 West Washington
11 Phoenix, AZ 85007

12 COPY of the foregoing hand-delivered this
13 26th day of October, 2011, to:

14 ALJ Marc Stern
15 Arizona Corporation Commission/Hearing Division
16 1200 West Washington
17 Phoenix, AZ 85007

18 COPY of the foregoing mailed
19 this 26th day of October, 2011, to:

20 Charles R. Berry
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24 *Attorney for Respondents*

25 By: Paul Huynh